DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 05-0527
FINANCIAL INSTITUTIONS TAX
FOR TAX YEARS 2000-2004

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ISSUE

I. **Financial Institutions Tax**- Nexus

Authority: I.C. 6-5.5-2-1(a); I.C. 6-5.5-3-1; 45 I.A.C. 17-2-1(a); I.C. 6-5.5-1-17(d); 45 I.A.C. 17-2-8; Quill Corporation v. North Dakota, 504 U.S. 298 (1992); Trinova Corp. v. Michigan Dep't of Treasury, 498 U.S. 358 (1991); Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931); Indiana Department of Revenue Commissioner's Directive No. 14 (August 1990).

Taxpayer protests whether it had nexus with Indiana for imposition of the Financial Institutions Tax.

II. **Financial Institutions Tax**- Responsible Party in Liquidation

Authority: I.C. 6-8.1-5-1(b); I.C. 6-8.1-10-9.

Taxpayer protest whether the Department can collect a financial institutions tax assessment against a liquidated entity.

III. **Tax Administration**- Penalty

Authority: I.C. 6-8.1-10-2.1; 45 I.A.C. 15-11-2.

The taxpayer protests the imposition of penalties.

STATEMENT OF FACTS

Taxpayer was a wholly-owned subsidiary of a national retailer ("Parent Company"). The taxpayer was established as a federally chartered credit card bank. The taxpayer's main operations involved managing the private-label credit card program of the Parent Company and extending credit to customers of the Parent Company to facilitate retail sale transactions. On July 31, 2004, the Parent Company sold the taxpayer's operations to another financial institution and the taxpayer ceased operations. The Department conducted an audit investigation and determined the taxpayer came within the purview of the Indiana financial institutions tax. The Department issued proposed assessments for tax years 2000-2004. The Parent Company submitted a protest challenging the assessment on behalf of the taxpayer. The Department held a hearing and now presents this Letter of Findings, with additional facts to follow.

I. **Financial Institutions Tax**- Nexus

DISCUSSION

The taxpayer disputes the imposition of the financial institutions tax. The taxpayer states the Department seeks to impose a tax merely based upon the taxpayer having an economic nexus in Indiana. The taxpayer argues in its December 2, 2005, protest letter that "notwithstanding Indiana's definition in its Financial Institutions Tax of transacting business within Indiana, the taxpayer is protected by the Due Process and Commerce Clause of the United States Constitution from imposition of the tax by Indiana."

The taxpayer explains under Quill Corporation v. North Dakota, 504 U.S. 298, 306 (1992), the U.S. Supreme Court held that the Commerce Clause of the U.S. Constitution requires an entity to have "substantial nexus" with a state in order for the state to tax such entity. The taxpayer believes since it did not have an office, employees, or any other physical presence in the state, its activities did not rise to a level to establish a "substantial nexus". Hence, the U.S. Constitution precludes Indiana from imposing the financial institutions tax on the taxpayer.

The taxpayer further explains "[t]he Due Process Clause…requires that a taxing provision must be struck if it causes taxation 'out of all appropriate proportions to the business transacted…in that State', or has 'led to a grossly distorted result.'" Trinova Corp. v. Michigan Dep't of Treasury, 498 U.S. 358, 380 (1991); Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931). The taxpayer maintains that all of its business transactions are performed outside of Indiana. As such, the tax assessment as computed under the single sales factor apportionment formula is not in proportion to the taxpayer's activities in Indiana and is in violation of the Due Process Clause.

There is imposed on each taxpayer a franchise tax for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana. I.C. 6-5.5-2-1(a). A taxpayer is "transacting the business of a financial institution" when:

(1) For a holding company, a regulated financial corporation, or a subsidiary of either, the activities that each is authorized to perform under federal or state law, including the activities authorized by regulation or order of the Federal Reserve Board for such subsidiary under Section 4(c)(8) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8), as in effect on December 31, 1990.

(2) For any other corporation described in subsection (a)(4), all of the corporation's business activities if eighty percent (80%) or more of the corporation's gross income, excluding extraordinary income, is derived from one (1) or more of the following activities:

(A) Making, acquiring, selling, or servicing loans or extensions of credit. For the purpose of this subdivision, loans and extensions of credit include:

(i) secured or unsecured consumer loans;
(ii) installment obligations;
(iii) mortgage or other secured loans on real estate or tangible personal property;
(iv) credit card loans;
(v) secured and unsecured commercial loans of any type;
(vi) letters of credit and acceptance of drafts;
(vii) loans arising in factoring; and
(viii) any other transactions with a comparable economic effect.

(B) Leasing or acting as an agent, broker, or advisor in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes.

(C) Operating a credit card, debit card, charge card, or similar business….

I.C. 6-5.5-1-17(d).

The Financial Institutions Tax (FIT) is intended to tax both traditional financial institutions (such as banks and savings and loans, etc.), that are transacting business within Indiana, as well as other types of businesses that are deemed to be transacting the business of a financial institution in Indiana. 45 I.A.C. 17-2-1(a). A taxpayer is not required to have a physical presence within Indiana for the imposition of the Financial Institution Tax. 45 I.A.C. 17-2-8. I.C. 6-5.5 adopts an economic presence method for determining the jurisdictional basis for taxing nonresidents who conduct the business of a financial institution in Indiana. Indiana Department of Revenue Commissioner's Directive No. 14 (August 1990). For purposes of the Indiana financial institutions tax, a taxpayer "is transacting business within Indiana in a taxable year only if the taxpayer:

(1) maintains an office Indiana;

(2) has an employee, representative, or independent contractor conducting business in Indiana;

(3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;

(4) regularly solicits business from potential customers in Indiana;

(5) regularly performs services outside Indiana that are consumed within Indiana;

(6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana

(7) owns or leases tangible personal or real property located in Indiana; or
(8) regularly solicits and receives deposits from customers in Indiana."

I.C. 6-5.5-3-1.

The audit investigation determined the taxpayer solicited business in Indiana either through its Parent Company, or through its own advertising, or through a combination of the two. As a result, customers of the Parent Company would utilize credit cards issued by the taxpayer to purchase goods at the Parent Company's store locations. At a later date, the customer would repay the amounts to the taxpayer. This repayment resulted in the taxpayer deriving receipts from within Indiana. These facts indicate that the taxpayer transacted business in Indiana under either I.C 6-5.5-3-1(4), or I.C. 6-5.5-3-1(6), or under both of the provisions. When a taxpayer satisfies I.C. 6-5.5-3-1, this indicates the taxpayer's economic presence within the state. Once this economic presence is identified, the taxpayer is deemed to have sufficient nexus with the state for the imposition of the financial institutions tax. Therefore, the audit investigation was correct in its determination that the taxpayer had sufficient nexus with Indiana for the imposition of the financial institutions tax. With respect to the taxpayer's arguments that the Commerce Clause precludes the Department from imposing the tax and whether the tax violates the Due Process Clause, the Department declines to address these arguments on the grounds that an administrative hearing is not the proper venue to raise a constitutional challenge of the financial institutions tax. Taxpayer's constitutional challenges are more appropriately resolved in the Indiana Tax Court.

FINDING

The Department denies the Taxpayer's protest.

II. **Financial Institutions Tax**- Responsible Party in Liquidation

DISCUSSION

The taxpayer disputes whether the Department can hold a liquidated entity liable for the financial institutions tax. The taxpayer claims in its December 5, 2005, protest letter that "the Indiana statutes and regulations do not provide the Department with the authority to collect the assessed Financial Institutions Tax from [the taxpayer] because it is no longer in existence." The taxpayer explains in the letter that,

> "Indiana statutes and regulations only hold an officer responsible for payment of trust taxes (i.e., sales tax and withholding tax) in the event a taxpayer no longer exists as an entity to pay the liability. (I.C. 6-2.5-9-3 & I.C. 6-3-4-8) The Indiana Financial Institutions Tax statutes and regulations do not provide for similar responsible officer liabilities. Therefore, the Department cannot hold [the taxpayer's] former officers and /or shareholders responsible for the assessed Financial Institutions Tax."

Indiana Department of Revenue assessments are prima facie evidence that the department's claim for unpaid taxes is valid. I.C. 6-8.1-5-1(b). The taxpayer has the burden of proving whether the department incorrectly imposed the assessment. Id.

I.C. 6-8.1-10-9(a)(2) states a "[l]iquidation means the operation or act of winding up a corporation's affairs, when normal business activities have ceased, by settling its debts and realizing upon and distributing its assets." When this occurs, the officers and directors of the corporation effecting dissolution, liquidation, or withdrawal shall do the following: (1) file all necessary tax returns in a timely manner; (2) make all tax payments due or determined due to the department in a timely manner; and (3) file with the department a form of notification within thirty (30) days of the issuance of a certificate of dissolution, decree of dissolution, the adoption of a resolution or plan, or the filing of a statement of withdrawal. I.C. 6-8.1-10-9(b). Unless a clearance is issued "for a period of one (1) year following the filing of the form of notification with the department, or the filing of all necessary tax returns as required by this title…the corporate officers and directors remain personally liable…for any acts or omissions that result in the distribution of corporate assets in violation of the interests of the state…." I.C. 6-8.1-10-9(c). The corporation's officers' and directors' personal liability includes all taxes, penalties, interest, and fees associated with the collection of the liability due the department. I.C. 6-8.1-10-9(d). The issuance of a clearance by the department under I.C. 6-8.1-10-9(g) releases the officers and directors from personal liability. I.C. 6-8.1-10-9(h).

The Department does not accept the taxpayer's argument as a sufficient reason to cancel the tax. A liquidation of the company will not preclude the Department from pursuing collection on an assessment. Under I.C. 6-8.1-10-9(d), a corporation's officers' and directors will remain personally liable for "all taxes, penalties, interest, and fees associated with the collection of the liability due the department." The only way a corporate officer or director can avoid personal liability for the assess tax is to have the Department issue a clearance. The taxpayer provides no evidence that the Department issued a clearance to its corporate officer's and directors. Therefore, the corporate officers and directors still remain personally liable for the tax assessment.

FINDING

The Department denies the Taxpayer's protest.

III. **Tax Administration** – Penalty

DISCUSSION

The taxpayer requests the Department waive the assessment of penalties on the tax liability. The taxpayer argues it exercised reasonable care, caution, and diligence in attempting to report and remit the tax owed the Department. To support its argument, the taxpayer requests the Department take the following facts into consideration: it maintains no physical presence in the state; the protested issues involve an unsettled area; and during a 1998 prior audit of the Parent Company, in which the taxpayer was still in existence, the Department never raised the issue.

I.C. 6-8.1-10-2.1(a)(3) provides in part that "if a person… incurs, upon examination by the department, a deficiency that is due to negligence…the person is subject to a penalty." Negligence is defined "as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer…." 45 I.A.C. 15-11-2(b). Negligence is

"determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

The Department may waive the penalty upon a showing that the failure to pay the deficiency was due to reasonable cause and not due to willful neglect. I.C. 6-8.1-10-2.1(d). However, in order to establish reasonable cause, the taxpayer must demonstrate that the taxpayer "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed…." 45 I.A.C. 15-11-2(c).

The taxpayer has not affirmatively established that its failure to pay the tax was due to "reasonable cause". As stated in Issue I, the financial institutions tax requires only an economic presence for imposition of the tax. It is not imperative for imposition of the tax that a taxpayer have a physical presence with the state. The statutes and administrative code are clear with respect to the scope of the financial institutions tax. Moreover, the prior audit the taxpayer mentions is not relevant because the prior audit may have encompassed non-related issues particular to the Parent Company and not the taxpayer. Accordingly, the taxpayer's assertions do not rise to a level of "reasonable cause" sufficient to permit the Department to waive the negligence penalty.

FINDING

The Department denies the Taxpayer's protest

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